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Sales tax on Prepared Food increases to 7% effective October 1, 2001

The Maine legislature recently enacted a sales tax increase from 5% to 7% on all food prepared by a retailer effective October 1, 2001. Previously the 7% rate applied only to those establishments that were licensed to serve alcoholic beverages on premises. Although often referred to during the legislative session as well as in the media as a “meals tax”, the enacted language applies the 7% rate to all food that any retailer prepares. This will affect all forms of prepared food, from coffee or a steamed hot dog sold by a convenience store to a meal sold by a fast food chain.

Those retailers who were previously filing the “short” version of the sales tax return will be required to file the “long” version and report any taxable prepared food sales on line 5. Since MRS is unable to determine which retailers will be affected by this change, the use of the “short” version of the sales tax return will be temporarily suspended. All sales tax accounts will file the “long” version beginning October 1, 2001. MRS plans to re-analyze sales tax accounts and reinstate the “short” version for qualifying retailers early in 2002.

This change will also have the effect of imposing multiple rates of tax in many retail establishments. For instance a convenience store selling prepared food will be faced with collecting 7% tax on food that they have prepared such as coffee or steamed hot dogs, and 5% on taxable items such as soda, beer and candy. Retailers are advised to verify that their cash registers or point-of-sale equipment can accommodate multiple tax rates.

This notice presents information about the change in law in two formats; an in-depth explanation of the definition of “prepared food” and its impact and an abbreviated “Quick Answer” chart.

The new definition of “prepared food” contains three categories:

- ❶ all meals served on or off the premises of the retailer
- ❷ all food and drink prepared by the retailer and ready for consumption without further preparation and
- ❸ all food and drink sold by a retailer that is predominately in the business of selling food prepared by that retailer.

❶ Meals served on or off the premises of the retailer

This category includes any meal sold by any retailer whether served at the retailer’s place of business or off site. It includes all food or drink prepared for consumption at tables, chairs or counters or from trays, glasses, dishes or other tableware provided by the retailer. Common retailers included in this category are restaurants, fast food chains, cafeterias, caterers and other eateries providing sit down service. The only change for retailers in this category is the increase in tax on all meals from 5% to 7%. Those retailers who currently charge 7% have no change.

Sandwiches requiring no further preparation and food heated by the retailer are considered “meals”, whether prepared by the retailer or a third party, and regardless of the type of retailer making the sale.

❷ Food and drink prepared by the retailer and ready for consumption without further preparation

This category includes all food and drink that is prepared by any retailer and that is ready to eat. “Prepared by the retailer” means:

- Food prepared for sale in a heated state regardless of cooling which may have occurred prior to the sale. Some examples are hot dogs, hamburgers, hot sandwiches, pizza, chicken pieces and rotisserie chicken.
- Mixing or combining two or more food ingredients for sale as a single item, such as bakery items, sandwiches, deli platters, salads and desserts.
- Food or drink prepared from syrups or mixes, such as soda fountain drinks, slush-type drinks, soft-serve ice cream and milk shakes.
- Food or drink sold with eating utensils provided by the retailer, including plates, knives, forks, spoons, glasses, cups, napkins or straws.
- Food that is prepared for sale in self-serve areas, such as salad bars and self-serve food carts.

The change for most of the food and drink in this category will be the increase in sales tax from 5% to 7% tax. Some of these items are exempt under current law and will become taxable at 7%.

Example 1: A snack bar prepares hot dogs, hamburgers, sandwiches, fountain drinks, slush-type drinks and soft serve ice cream. The tax on these items will increase from 5% to 7%.

Example 2: A grocery store prepares sandwiches, hot chicken, cole slaw, potato salad and also prepares food for a salad bar where customers can create their own salads. Currently, only the sandwiches and hot chicken are taxable at 5%. The new law will apply the 7% tax to all these items since they are “prepared by the retailer”, except “bulk sales of grocery staples”*.

Example 3: A convenience store sells hot dogs, pizza slices, sandwiches, hot coffee, fountain drinks, and slush-type drinks. The tax on these items will increase from 5% to 7%.

Example 4: A bakery prepares and sells bread and bread products, doughnuts, muffins, pastries, cakes, pies and hot coffee. Currently, some bakeries impose a 5% tax on doughnuts, muffins, etc. sold in quantities of less than 6 and hot coffee. The new law will apply the 7% tax to all items in the bakery since they are “prepared by the retailer”, except “bulk sales of grocery staples”*.

*** See exclusion below for bulk sales of grocery staples for items that are exempt from tax.**

③ Food and drink sold from an establishment that is predominately in the business of selling prepared food for immediate consumption (75% rule)

This category attempts to identify those retailers who are similar in nature to a restaurant rather than a grocery store. If a retailer qualifies under this category, the retailer is required to charge 7% tax on all of its sales of food and drinks requiring no further preparation, whether prepared by the retailer or not.

Unlike the 75% rule under the current law, this computation is simpler and will affect less retailers. The two factors to compare are 1) sales of food prepared by the retailer and 2) total sales. If dividing (1) by (2) generates a percentage of more than 75%, the retailer is affected by this category.

“Sales of food prepared by the retailer” include all food that the retailer prepares, including hot food, hot drinks, sandwiches, bakery items, soda fountain drinks, slush-type drinks, ice cream served in a cup, cone or dish, and milkshakes. “Total sales” include all receipts by the retailer, including grocery staples, prepared food, cigarettes, beer, wine, soda, candy, gasoline, and periodicals; rental income from the rental of space at the retailer’s site, such as space for vendors, room rentals and campsite rentals; and revenue generated at the retailer’s site from other sources, such as admittance fees and equipment rentals.

A retailer who meets the 75% rule must collect 7% tax on all sales of food or drink requiring no further preparation, not just on food prepared by that retailer. (See exception below for bulk sales of grocery staples.) Sales of individually packaged pastries, chips, cookies, etc. and drinks including soda, water, juice, milk, etc. and candy would all be taxed at 7% along with the food prepared by the retailer.

A retailer who does not meet the 75% rule must collect 7% tax on only those sales of food prepared by the retailer as mentioned in the prior section. Sales of otherwise taxable items, such as soda, beer, wine, candy, ice, cigarettes, etc. would continue to be taxed at 5%. Sales of grocery staples, including snack items, milk, juice, etc. would all be exempt.

Example 1: A convenience store prepares and sells sandwiches, pizzas, and soda fountain drinks. In addition it sells convenience foods, a small line of grocery staples, candy, beer, wine, cigarettes and gasoline. Its total sales for the year are \$500,000. Sales of “prepared food” (sandwiches, pizzas and soda fountain drinks) for the year are \$125,000. Because only 25% of its total sales are prepared food, this store would charge 7% tax only on its prepared food.

Example 2: A sandwich shop prepares and sells sandwiches, pizzas, pasta dishes, hot dogs, hamburgers, and soda fountain drinks. In addition it sells chips, pastries, candy, soda, water, beer, juices and milk. Its total sales for the year are \$300,000. Sales of “prepared food” (sandwiches, pizzas, pasta dishes, hot dogs, hamburgers, and soda fountain drinks) for the year are \$240,000. Since more than 75% of its total sales are prepared food (80%), this retailer would charge 7% tax on all its sales of food and drink that do not require further preparation (chips, pastries, candy, soda, water, beer, juices and milk).

Exclusion for bulk sales of grocery staples

The definition of “prepared food” does provide one exclusion. “Bulk sales of grocery staples” are exempt regardless of the location from which they are sold. Some examples of food prepared by the retailer that qualify as bulk sales of grocery staples are:

- pies, cakes, desserts and bread and bread products, except those packaged as a single serving
- donuts, muffins, pastries, cookies, etc. sold in quantities of 6 or more
- products sold in the “deli case”, such as salads, luncheon meats and cheese, except sandwiches and food prepared for sale in a heated state regardless of cooling which may have occurred prior to the sale
- ice cream packaged in quart or larger containers, maple syrup, jam, jellies, pickles, honey, and spaghetti sauce

For retailers who meet the 75% rule, “bulk sales of grocery staples” also include:

- a bag of coffee
- salad dressing
- drinks, including milk and juice, in quart or larger containers
- potato chips, corn chips and similar items packaged in 6 ounce or larger containers
- packages of cookies, crackers, etc. except those packaged as a single serving

Quick Answer Chart

| <i>Type of Retailer</i> | <i>Current Law</i> | <i>New Law – October 1, 2001</i> |
|---|---|--|
| Restaurant/cafeteria | Those licensed to serve alcoholic drinks charge 7%; all others charge 5% | All food and drink sales are subject to 7% at all restaurants and cafeterias |
| Sandwich shop | Hot food, hot drinks, sandwiches, individual chips, cookies, pastries, drinks subject to 5% tax. | All food and drink sold by the sandwich shop is taxable at 7%, unless categorized as a bulk sale of a grocery staple. |
| Bakery | Hot food, hot drinks and sandwiches subject to 5% tax | All food and drink prepared by the bakery is taxable at 7%, unless categorized as a bulk sale of a grocery staple. |
| Supermarket | Hot food, hot drinks and sandwiches subject to 5% tax | All food and drink prepared by the supermarket is taxable at 7%, unless categorized as a bulk sale of a grocery staple. |
| Convenience Store | Hot food, hot drinks and sandwiches subject to 5% tax. If 75% rule applies, individual chips, cookies, pastries, drinks, etc are taxable at 5%. | All food and drink prepared by the convenience store is taxable at 7%. The new 75% rule will exclude the majority of c-stores since the comparison looks at all sales, including beer, wine, cigarettes and gasoline. (See 75% rule comparison below) |
| Dairy Bar/Roadside Stand | All sales subject to 5% tax except ice cream cakes | All sales subject to 7% tax. Ice cream cake continues to be exempt as a bulk sale of a grocery staple. |
| Street Vendor | All food and drink sales subject to 5% tax | All food and drink sales subject to 7% tax. |
| Caterer | All sales subject to 5% tax | All sales subject to 7% tax |
| Concession stands and snack bars – (civic centers, stadiums, bowling alleys, ice rink, etc) (owner operated) | All sales subject to 5% tax | If 75% rule applies, all food and drink sales subject to 7% tax. If not, all food and drink prepared by the retailer is taxable at 7%. Other sales, such as candy, soda, and beer, are taxable at 5%. Sales of snack items and other grocery staples are exempt. |
| Concession stands and snack bars – (civic centers, stadiums, bowling alleys, ice rink, etc) (contractor operated) | All sales subject to 5% tax | All food and drink sales subject to 7% tax. |

Comparison of the old and new 75% rule

| Current 75% rule | | New 75% rule | |
|--------------------------------|--|--------------------------------|---|
| Numerator | Hot food, hot drinks, sandwiches, individual chips, cookies, pastries, drinks, etc. | Numerator | All food and drink prepared by the retailer |
| | <i>divided by</i> | | <i>divided by</i> |
| Denominator | Hot food, hot drinks, sandwiches, individual chips, cookies, pastries, drinks, etc., and all grocery staples | Denominator | Total sales |
| | | | |
| Items taxed if 75% rule is met | Hot food, hot drinks, sandwiches, individual chips, cookies, pastries, drinks, etc. | Items taxed if 75% rule is met | All food and drink unless categorized as a bulk sale of a grocery staple. |